

AUDIT SUMMARY

Our audit of the Department of Mental Health, Mental Retardation, and Substance Abuse Services (the Department) for the year ended June 30, 1998, found:

- that the Department is currently experiencing financial difficulties in the special revenue fund;
- internal control matters that we consider to be reportable conditions; however, we do not consider any of these to be material weaknesses;
- that amounts reported in the Commonwealth Accounting and Reporting System were fairly stated; and
- no issues of noncompliance with applicable laws and regulations that are required to be reported.

We recommend the Department:

- adequately address the special revenue fund issues;
- continue Year 2000 efforts;
- continue completion of the Information Security Plan; and
- ensure proper capital outlay management.

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AGENCY OVERVIEW

The Department of Mental Health, Mental Retardation, and Substance Abuse Services (the Department) consists of nine mental health facilities, five training centers, one medical center, and a central office. Facilities must meet standards of quality set by the Joint Commission for Accreditation of Health Care Organizations, the U.S. Health Care Financing Administration, and the U.S. Department of Justice.

The Department funds 40 community services boards (CSBs), which allow local governments to establish and maintain community mental health, mental retardation, and substance abuse programs. CSBs function as service providers, client advocates, community educators, program developers, and service planners. The Department allocated over \$175 million to CSBs in fiscal year 1998. Other CSBs funding sources include Medicaid, local government taxes and contributions, workshop fees, and miscellaneous revenues.

Beginning July 1, 1999, CSBs will administer state-funded programs using a performance contract. If CSBs do not meet the performance standards in the contract, the Department may contract with other entities to provide local services.

FINANCIAL STATUS

Over 40 percent, or \$245 million, of the Department's funding for operations comes from the collection of billings for patient services. Like other health care providers, the Department bills Medicaid, Medicare, insurance carriers, and patients for treatment services. With declining inpatient levels and a shift to community-based services, the Department is experiencing difficulty in raising and maintaining this level of revenue. Current projections of patient revenue indicate that the Department may have a shortage as great as \$4 million at June 30, 1999, and will not have sufficient cash to repay its entire treasury loan on September 1, 1999. Without implementing certain corrective actions, the potential exists for increasingly larger deficits in the future.

Several factors contribute to the potential shortfall, some of which are beyond the Department's ability to manage and control. Other factors, however, relate to the Department's inability to accurately project revenue collections and coordinate and control operations among the facilities. If the Department cannot find means to offset the decline in revenues, it will need to either request increased budgetary support from the General Fund of the Commonwealth or reduce services. Declining inpatient population will eventually result in the need to take one of these actions if the Department continues to maintain the level of service delivery expected by current patient populations.

We identified four factors contributing to the current revenue situation that affect the Department's ability to respond:

1. changes in Medicare daily patient reimbursements and disallowed Medicare cost report amounts;
2. Medicaid's reimbursement restrictions limit payments for services;
3. U.S. Department of Justice's reviews have increased the cost of services at certain facilities which limit the Department's ability to control total costs; and
4. the Department's processes do not support or provide information for accurate projections of both revenues and costs control.

In addition, the Department is making a concerted effort to move patients from an institutional to a community-based environment, which reduces patient level and revenue. If the Department continues the same mixture of programs and methods of program delivery, there will be a need for increased participation by the General Fund of the Commonwealth in funding operations.

Following our discussion of each of the factors below, we provide the actions the Department is undertaking to address the situation.

1. Changes in Medicare daily patient reimbursements and disallowed Medicare cost report amounts

In April 1998, Trigon Blue Cross/Blue Shield performed a clinical audit at Western State Hospital (the Hospital) of its 1996 cost report and found:

- the Hospital received payments for outpatient ancillary services that Medicare considers noncovered services, such as medications and routine social services;
- outpatient ancillary services payments included services provided from noncovered locations; and
- the Hospital received payments for services provided by noncertified clinical staff, such as nonlicensed social workers and noncertified occupational staff.

The Hospital audit findings resulted in the repayment of \$2.3 million dollars to Medicare during fiscal year 1999. Medicare determined that four other facilities provided similar outpatient ancillary services and subsequently, applied the questioned cost finding for drugs and other services to these facilities as well.

The overall consequence of the audit and its application to other facilities resulted in the repayment of \$7.3 million by the Department to Medicare during fiscal year 1999. In July 1998, Medicare instructed the Department to revise their interim per diem billing rate to reflect the disallowance of the questioned costs. The Department estimates a reduction of approximately \$8.2 million of fiscal year 1999 revenues due to adjusted per diem billing rates. Medicare also informed the Department that it is reopening the cost settlements for fiscal years 1994, 1995, and 1996. The Department has not yet concluded the cost settlement process with Medicare for the fiscal years 1997 and 1998. Should Medicare apply the same audit sanctions to these years as well, the Department estimates a potential repayment to Medicare of approximately \$21 million.

Departmental Action

The Department and the Office of the Attorney General submitted an appeal to Medicare and received a tentative hearing date of January 2001. In addition, Medicare has tentatively scheduled a follow-up audit during fiscal year 2000.

The Department is correcting the situations that led to Trigon's findings in an effort to reduce the risk of further billing problems. The Department continues work on the partial recovery of these Medicare costs through the reclassification of patients to the Medicaid

program. This action will indirectly lead to an increased General Fund participation in the Medicaid program at the Department of Medical Assistance Services (DMAS).

2. Medicaid's reimbursement restrictions limit payments for services

DMAS sets upper limitations on the cost amount per patient day that the Department can claim for Medicaid reimbursement to determine the reasonable cost recovery for a provider. When setting the annual Medicaid upper payment limitation, DMAS increases the existing limit by a national specific rate used as a cost inflation factor. DMAS may also vary the limit for a facility if it believes unique circumstances exist and a waiver is warranted.

The Department's costs of providing services exceeded the cost recovery limit set by DMAS. Meeting the requirements of operations set by the Department of Justice contributed to the excess to a greater degree than the inflationary cost related to salaries and general expenses. However, the primary reason for exceeding the DMAS limit is because the Department maintains the same level and mixture of services while the inpatient population continues to decline. The total cost per-facility remains relatively constant, but when allocated on a per-patient basis, cost-per-patient increases as the inpatient population decreases. For example, if total patient costs are \$100, the cost per-patient is \$1 with 100 patients. If total costs remain constant and the patient population drops to 50 patients, the cost-per-patient increases to \$2.

The following table illustrates the increases in per-patient cost as the population declines and includes inflation and the settlement with the Department of Justice (Justice).

Year	Total Patient Cost	In-Patient Population	Per-Patient Cost
1994	\$376,514,181	4,924	\$76,465
1995	\$386,355,686	4,666	\$82,802
1996	\$374,750,082	4,425	\$84,689
1997	\$369,583,890	4,176	\$88,502
1998	\$405,950,393	4,048	\$100,284
1999*	\$406,197,669	3,812	\$106,557

* as of 05/31/1999

The Department has taken the position that DMAS' limit has always been too low. It also believes that DMAS should provide consideration for the Department's work with Justice and its general circumstances and that it should grant a waiver of the limit due to the nature and type of patients served by the Department.

Departmental Action

The Department requested that DMAS grant a waiver to the Medicaid upper payment limitation. DMAS indicated that it will consider a waiver and asked the Department to submit information concerning its costs and include the desired upper limit. Receiving a waiver will positively impact the Department's cash flow and revenues; however, the ultimate impact cannot be determined without knowing the extent of the waiver. Additionally, this waiver may represent only a partial solution to the Department's problem since long term declining populations will continue to increase costs and reduce revenues.

3. U.S. Department of Justice's reviews have increased the cost of services at certain facilities which limit the Department's ability to control total costs

Justice has reviewed state mental health facilities since 1990 to ensure compliance with the Civil Rights for Institutionalized Persons Act (CRIPA). The investigation of five facilities resulted in changes to the method of service delivery and includes increasing professional staff, focusing more on individualized active treatment, and accelerating the return of patients into the community. The majority of these new requirements will require future funding to maintain higher staffing levels. To date, Justice reviews have resulted in \$10.6 and \$21.3 million appropriation increases for fiscal years 1998 and 1999, respectively.

Departmental Action

The Department, in conjunction with the Office of the Attorney General, contracted with a consultant to review state psychiatric facilities for compliance with CRIPA requirements. The consultant identified a number of significant concerns in the areas of treatment and management, in addition to other system-wide issues in all nine facilities. The Department plans to request needed funds to meet capital and personnel requirements to ensure all facilities meet CRIPA standards in the next biennium.

4. The Department's processes do not support or provide information for the accurate projection of both revenues and costs control

The Department's staff had trouble providing the Secretary, the Commissioner, and the auditors with information on the status of funding and the effect that certain alternatives would have on the funding status. While internal systems provide accurate historical data, the conversion of this information into future budgets and cash flow data is a time-consuming, complex, and possibly inaccurate process.

The need for analytical information regarding the Department's operations is essential when policymakers face multiple decisions concerning not only funding, but the delivery and timing of services. In addition, current systems do not allow financial staff to provide the Commissioner with information needed to accurately direct spending patterns or review costs. Providing this type of information requires financial systems that couple and utilize data from other sources such as patient information, budgetary trends, allowable cost changes, and anticipated purchasing needs. It is equally important to have staff who can analyze data, reasonably predicate the results of current trends, and provide this information to the Secretary, the Commissioner and other agencies in a timely, accurate, and consistent way. This information must provide credible support of the Department projections and decisions. Finally, this process should allow the Department to respond proactively to situations by anticipating issues.

OTHER MANAGEMENT ISSUES

Year 2000 Compliance

The Department identified ten mission-critical systems, eight of which will be compliant by July 1, 1999. The noncompliant systems, the critical incident and Medicaid databases, are expected to enter the testing and validation phase in early July 1999. The Department and each facility are revising their contingency plans for systems and operations in the event a system fails and expect to have final contingency plans completed by August 30, 1999.

Information Security Plan

The Department has completed a risk assessment and information security plan to encompass its HP3000 mainframe. The security plan to address the client server network is incomplete, though the Department has assembled a working draft of the Client Server Disaster Recovery Plan. The information security plan is necessary to ensure the Department limits its vulnerability to risks in the client server environment.

Capital Outlay Management

We identified the following issues of noncompliance with the Commonwealth of Virginia's Construction and Professional Services Manual for Agencies in one of two projects tested:

- project change orders were paid without proper authorization;
- capital outlay forms CO-13.2, "Certificate of Completion By Contractor," and CO-13.3, "Certificate of Use and Occupancy," were not available for review in contract files; and
- payment of architect and engineer retainer fees were made prior to completion of an approved capital outlay form CO-14, "Project Completion Report."

The Department should comply with the Commonwealth of Virginia's Construction and Professional Services Manual for Agencies to ensure proper administration and management of capital outlay projects.

June 21, 1999

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Richard J. Holland
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

INDEPENDENT AUDITOR'S REPORT

We have audited the financial records and operations of the **Department of Mental Health, Mental Retardation, and Substance Abuse Services** (the Department) for the year ended June 30, 1998. We conducted our audit according to the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to review the Department's accuracy of recording financial transactions on the Commonwealth Accounting and Reporting System, adequacy of the internal control structure, and compliance with applicable laws and regulations. We also reviewed the Department's corrective action of audit findings from prior year reports.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Department's operations. We also tested transactions and performed such other auditing procedures, as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, transaction classes, and account balances:

- Revenue and Cash Receipts
- Payroll
- Expenditures

We obtained an understanding of the relevant policies and procedures for these internal accounting controls. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Department's policies and procedures were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Department's management has responsibility for establishing and maintaining an internal control structure and complying with applicable laws and regulations. The objectives of an internal control structure are to provide reasonable, but not absolute, assurance that assets are safeguarded and those transactions are processed in accordance with management's authorization, recorded properly, and comply with applicable laws and regulations.

Our audit was more limited than would be necessary to provide an opinion on the internal control structure or on overall compliance with laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of the internal control structure to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Audit Conclusions

We found that the Department properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

We noted certain matters involving the internal control structure and its operation that we considered to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial records. These reportable conditions are discussed; however, we found immaterial instances of noncompliance which are discussed in the section entitled, "Other Management Issues." We believe none of the reportable conditions in this report are material weaknesses. The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported under generally accepted government auditing standards.

The Department has not taken adequate corrective action with respect to the previously reported finding, "Risk Assessment and Information Security Plan." Accordingly, we included this finding in the section entitled, "Other Management Issues." The Department has taken adequate corrective action with respect to audit findings reported in the prior year that are not repeated in this report.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on July 9, 1999.

AUDITOR OF PUBLIC ACCOUNTS

DEPARTMENT OF MENTAL HEALTH, MENTAL RETARDATION,
AND SUBSTANCE ABUSE SERVICES
Richmond, Virginia

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